

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type: <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name: <u>Three Rivers Area Hospital Authority</u>	County St. Joseph
Audit Date December 31, 2003	Opinion Date February 26, 2004	Date Accountant Report Submitted To State:	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.


We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations.

You must check the applicable box for each item below:

- | | |
|---|---|
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91] or P.A. 55 of 1982, as amended [MCL 38.1132]) |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Reports on individual federal assistance programs (program audits).	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Single Audit Reports (ASLGU).	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>

Certified Public Accountant (Firm Name): PLANTE & MORAN, PLLC			
Street Address 67 West Michigan Avenue, Suite 500	City Battle Creek	State MI	ZIP 49017
Accountant Signature 			

Three Rivers Area Hospital Authority

Financial Report

December 31, 2003

Three Rivers Area Hospital Authority

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Independent Auditor's Report

To the Board of Trustees
Three Rivers Area Hospital Authority

We have audited the accompanying consolidated statement of net assets of Three Rivers Area Hospital Authority as of December 31, 2003 and 2002, and the related consolidated statements of revenue, expenses and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Three Rivers Area Hospital Authority at December 31, 2003 and 2002, and the results of its consolidated operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the consolidated financial statements, the Facility adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* as of January 1, 2003.

The Management's Discussion and Analysis presented on pages 2 - 9 is not a required part of the basic consolidated financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and, accordingly, do not express an opinion thereon.

Plante & Moran, PLLC

February 26, 2004

Three Rivers Area Hospital Authority

Management's Discussion and Analysis

Management's Discussion and Analysis

The discussion and analysis of Three Rivers Area Hospital Authority's financial statements provides an overview of the Hospital's financial activities for the year ended December 31, 2003. Management is responsible for the completeness and fairness of the financial statements and the related footnote disclosures along with the discussion and analysis.

Using this Annual Report

In June 1999, GASB released Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. Changes in Statement No. 34 require a comprehensive one-line look at the entity as a whole.

The major changes from the fund basis financial statements presented by the Hospital in the past and the "one-line look at the entity as a whole" are as follows:

- New reporting standards - Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets, Statement of Cash Flows
- Establishing an operating and nonoperating basis of reporting whereby revenues that are charges for services are recorded as operating revenue. Essentially all other types of revenue are nonoperating or other revenue
- Reporting net assets versus fund balance by donor classification
- Reporting interest expense as a non-operating expense versus operating expense
- Reporting provision for bad debt expense as contra revenue versus operating expense

This annual financial report includes the report of independent auditors, this management's discussion and analysis, the financial statements in the above referred format and notes to financial statements.

Financial Highlights

The Hospital's financial position increased slightly during the year ended December 31, 2003. The current assets decreased by approximately \$998,000, or 14 percent from the prior year. In total, the Hospital's net assets remained basically unchanged from the previous year. This almost breakeven condition for the year ended December 31, 2003 was achieved by maintaining a 6.8 percent increase in operating revenues, an overall expense increase of 10.3 percent and a decrease in nonoperating expenses, net of nonoperating income of 28.0 percent.

Three Rivers Area Hospital Authority

Management's Discussion and Analysis (Continued)

The Statement of Net Assets and the Statement of Revenue, Expenses, and Changes in Net Assets

One of the most important questions asked about the Hospital's finances is, "Is the Three Rivers Area Hospital Authority as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Revenue, Expenses, and Changes in Net Assets report information on the Hospital as a whole and on its activities in a way that helps answer this question. When revenue and other support exceed expenses, the result is an increase in net assets. When the reverse occurs, the result is a decrease in net assets. The relationship between revenue and expenses may be thought of as Three Rivers Area Hospital Authority's operating results.

These two statements report the Three Rivers Area Hospital Authority's net assets and changes in them. You can think of Three Rivers Area Hospital Authority's net assets - the difference between assets and liabilities - as one way to measure the Hospital's financial health, or financial position. Over time, increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider many other non-financial factors, such as the trend in patient days, outpatient visits, conditions of the buildings, and strength of the medical staff, to assess the overall health of the Hospital.

The statements include all assets and liabilities using the accrual basis of accounting. All of the current year's revenue and expenses are taken into account regardless of when cash is received or paid.

Three Rivers Area Hospital Authority

Management's Discussion and Analysis (Continued)

Condensed Financial Information

The following is a comparative analysis of the major components of the Statement of Net Assets of the Hospital as of December 31, 2003:

	December 31		Change	
	2003	2002	Increase (Decrease)	Percent Change
Current assets	\$ 6,208,230	\$ 7,206,252	\$ (998,022)	-13.8%
Non-current assets	3,493,327	1,207,795	2,285,532	189.2%
Capital assets	13,647,072	14,421,559	(774,487)	-5.4%
Total assets	23,348,629	22,835,606	513,023	2.2%
Current liabilities	4,108,785	4,120,271	(11,486)	-0.3%
Long-term liabilities	9,411,660	8,919,055	492,605	5.5%
Total liabilities	13,520,445	13,039,326	481,119	3.7%
Net assets:				
Invested in capital assets, net of debt	4,370,150	4,459,158	(89,008)	-2.0%
Restricted for future capital project	1,255,000	-	1,255,000	100.0%
Restricted for debt service	158,160	119,593	38,567	32.2%
Unrestricted	4,044,874	5,217,529	(1,172,655)	-22.5%
Total net assets	\$ 9,828,184	\$ 9,796,280	\$ 31,904	

The primary change in the statement of net assets relates to additional assets limited as to use being available from unspent bond funds issued in preparation for the renovation project for the Hospital.

Three Rivers Area Hospital Authority

Management's Discussion and Analysis (Continued)

Operating Results for the Year

	Year Ended December 31		Change	
	2003	2002	Amount	Percent
Operating Revenue				
Net patient service revenue	\$ 33,694,482	\$ 31,597,781	\$ 2,096,701	6.6%
Other	164,759	110,141	54,618	49.6%
Total operating revenue	33,859,241	31,707,922	2,151,319	6.8%
Operating Expenses				
Salaries	13,882,985	12,721,954	1,161,031	9.1%
Other	19,563,835	17,588,086	1,975,749	11.2%
Total operating expenses	33,446,820	30,310,040	3,136,780	
Operating Income	412,421	1,397,882	(985,461)	-70.5%
Nonoperating Revenue (Expense)	(380,517)	(528,777)	148,260	-28.0%
Increase in Net Assets	31,904	869,105	\$ (837,201)	-96.3%
Net Assets - Beginning of year	9,796,280	8,927,175		
Net Assets - End of year	\$ 9,828,184	\$ 9,796,280		

Three Rivers Area Hospital Authority

Management's Discussion and Analysis (Continued)

Operating Revenues

Operating revenues include all transactions that result in the sales and/or receipts from goods and services, such as inpatient services, outpatient services, physician offices, and the cafeteria.

Operating revenue changes were a result of the following factors:

- Net patient service revenue had a 6.6 percent increase from prior year. This was attributable to rate increases being cancelled out by volume decreases. Gross patient revenue is reduced by revenue deductions and provision for bad debt expense. Revenue deductions are the amounts that are not paid to the Hospital under contractual arrangements primarily with Medicare, Medicaid, and Blue Cross Blue Shield. These revenue deductions increased from 37 to 40 percent as a percentage of gross revenue.

Operating Expenses

Operating expenses are all the costs necessary to perform and conduct the services and primary purposes of the Hospital. The operating expense changes were the result of the following factors:

- Salary and benefit costs increased by almost 12%. The increase was primarily related to raises and increased health insurance costs.
- Professional fees increased 13 percent due to unanticipated fees related to locum tenens, temporary substitute physician services.
- Insurance costs increased over 92%. This significant increase was entirely due to increases in malpractice insurance.

Nonoperating Revenue

Nonoperating revenue and expenses are all sources and uses that are primarily non-exchange in nature. They would consist primarily of donations, interest expense and investment income (including realized and unrealized gains and losses).

The decrease in nonoperating expenses was due to increased contributions to the Hospital. The total contributions were approximately \$140,000 up from \$30,000 last year.

Three Rivers Area Hospital Authority

Management's Discussion and Analysis (Continued)

Statement of Cash Flows

Another way to assess the financial health of a hospital is to look at the statement of cash flows. Its primary purpose is to provide relevant information about the cash receipts and cash payments of an entity during a period. The statement of cash flows also helps assess:

- An entity's ability to generate future net cash flows
- Its ability to meet its obligations as they come due
- Its needs for external financing

	Year Ended December 31	
	2003	2002
Cash Flows from Operating Activities	\$ 1,362,770	\$ 4,364,749
Cash Flows from Capital and Related Financing Activities	(1,079,312)	(2,343,559)
Cash Flows From Noncapital Financing Activities	139,225	(141,077)
Cash Flows from Investing Activities	<u>(1,180,224)</u>	<u>370,496</u>
Net Increase (Decrease) in Cash	(757,541)	2,250,609
Cash - Beginning of year	<u>3,441,753</u>	<u>1,191,144</u>
Cash - End of Year	<u>\$ 2,684,212</u>	<u>\$ 3,441,753</u>

The Hospital's liquidity decreased during the year. The following discussion amplifies the overview of cash flows presented above.

Cash provided by operating activities was less than last year, largely due to relatively unchanged patient revenues, with a larger increase in expenditures paid out during the year.

Cash spent on capital purchases was approximately \$1.1 million.

Cash invested in assets limited as to use was approximately \$1.2 million.

Three Rivers Area Hospital Authority

Management's Discussion and Analysis (Continued)

Capital Asset and Debt Administration

Capital Assets

At December 31, 2003, the Hospital had approximately \$34 million invested in capital assets, net of accumulated depreciation of \$20 million. Depreciation and amortization totaled approximately \$1.8 million for both 2003 and 2002. Details of the total cost of assets for the past two years are shown below.

	2003	2002
Land	\$ 219,500	\$ 219,500
Land improvements	903,382	891,674
Buildings and improvements	12,727,267	12,347,175
Furniture, fixtures, and equipment	16,046,223	15,558,381
Buildings and equipment under capital lease	<u>4,285,919</u>	<u>4,100,074</u>
Total	<u>\$ 34,182,291</u>	<u>\$ 33,116,804</u>

Debt

At year-end, the Hospital had \$7.7 million of bonds outstanding as compared to \$7 million the previous year.

The Hospital has made strides to pay down its debt obligations and has done so in alignment with its prescribed debt schedules. More detailed information about the Hospital's long-term liabilities is presented in the footnotes to the financial statements.

In 2004, the Hospital will enter into a renovation contract. The Hospital intends to finance these renovations with the funds obtained during the fiscal year ended December 31, 2003.

Three Rivers Area Hospital Authority

Management's Discussion and Analysis (Continued)

Economic Factors That Will Affect the Future

The economic position of the Hospital is closely tied to that of the local economy. Because of limited economic growth and increased demand for resources where reimbursement is limited by federal and state mandates, the current Medicare budget projects only an inflationary increase in funding to the Hospital in the next year of 2.0 percent. In addition, the Board of Trustees approved an average increase of 3 percent in the charge structure for the upcoming fiscal year.

The Hospital's current financial and capital plans indicate that the infusion of additional financial resources from the foregoing actions will enable it to maintain its present level of service.

Contacting the Authority's Management

This financial report is intended to provide our member townships and bondholders with a general overview of the Authority's finances. If you have questions about this report or need additional information, we welcome you to contact the Vice President of Financial Services.

Steve Andrews
Vice President of Financial Services

Three Rivers Area Hospital Authority

Consolidated Statement of Net Assets

	December 31	
	2003	2002
Assets		
Current Assets		
Cash (Note 2)	\$ 1,029,159	\$ 2,853,290
Assets limited as to use (Note 3)	158,160	119,593
Accounts receivable (Note 4)	4,127,411	3,358,823
Cost report settlements (Note 6)	-	200,000
Other current assets	893,500	674,546
Total current assets	6,208,230	7,206,252
Assets Limited as to Use (Notes 2 and 3)	3,493,327	1,207,795
Capital Assets, Net (Note 5)	13,647,072	14,421,559
Total assets	<u>\$ 23,348,629</u>	<u>\$ 22,835,606</u>
Liabilities and Net Assets		
Current Liabilities		
Current maturities of long-term debt (Note 7)	\$ 1,120,262	\$ 1,043,346
Accounts payable	651,209	813,726
Accrued expenses:		
Payroll and related withholdings	294,964	602,050
Paid time off	681,760	630,166
Interest and other	310,590	280,983
Cost report settlements (Note 6)	1,050,000	750,000
Total current liabilities	4,108,785	4,120,271
Long-term Debt (Note 7)	9,411,660	8,919,055
Total liabilities	13,520,445	13,039,326
Net Assets		
Invested in capital assets - Net of related debt	4,370,150	4,459,158
Restricted for future capital project	1,255,000	-
Restricted for debt service	158,160	119,593
Unrestricted	4,044,874	5,217,529
Total net assets	9,828,184	9,796,280
Total liabilities and net assets	<u>\$ 23,348,629</u>	<u>\$ 22,835,606</u>

Three Rivers Area Hospital Authority

Consolidated Statement of Revenue, Expenses and Changes in Net Assets

	Year Ended December 31	
	2003	2002
Operating Revenue		
Net patient revenue (net of provision for bad debts of \$2,544,296 in 2003 and \$2,429,947 in 2002)	\$ 33,694,482	\$ 31,597,781
Other revenue	164,759	110,141
Total operating revenue	33,859,241	31,707,922
Operating Expenses		
Salaries	13,882,985	12,721,954
Benefits	4,074,435	3,325,823
Fees:		
Physicians	3,053,112	2,941,121
Other	4,514,545	3,781,047
Supplies	3,358,517	3,597,895
Utilities	444,339	387,457
Repairs/Rental	653,865	611,873
Depreciation	1,839,974	1,864,149
Insurance	905,625	471,292
Other expenses	719,423	607,429
Total operating expenses	33,446,820	30,310,040
Operating Income	412,421	1,397,882
Nonoperating Income (Expense)		
Interest income	77,285	52,105
Contributions	139,225	28,925
Interest	(597,027)	(609,807)
Nonoperating income (expense), net	(380,517)	(528,777)
Increase in Net Assets	31,904	869,105
Net Assets - Beginning of year	9,796,280	8,927,175
Net Assets - End of year	<u>\$ 9,828,184</u>	<u>\$ 9,796,280</u>

Three Rivers Area Hospital Authority

Consolidated Statement of Cash Flows

	Year Ended December 31	
	2003	2002
Cash Flows from Operating Activities		
Cash received from patients and third-party payors	\$ 33,425,894	\$ 32,749,107
Cash received from other operating revenue	164,759	110,141
Cash paid to employees and suppliers	(32,227,883)	(28,494,499)
Net cash provided by operating activities	1,362,770	4,364,749
Cash Flows from Capital and Related Financing Activities		
Purchase and construction of capital assets	(879,642)	(639,080)
Proceeds from issuance of long-term debt	1,500,000	-
Principal paid on long-term debt	(1,116,324)	(1,058,361)
Interest paid on long-term debt	(583,346)	(646,118)
Net cash provided by (used in) capital and related financing activities	(1,079,312)	(2,343,559)
Cash Flows from Noncapital Financing Activities		
Payment on line of credit	-	(170,002)
Noncapital donations	139,225	28,925
Net cash provided by (used in) noncapital financing activities	139,225	(141,077)
Cash Flows from Investing Activities		
Interest received on investments	70,639	67,770
Sale of investment securities	696,773	708,448
Purchase of investment securities	(1,947,636)	(405,722)
Net cash provided by (used in) investing activities	(1,180,224)	370,496
Net Increase (Decrease) in Cash	(757,541)	2,250,609
Cash - Beginning of year	3,441,753	1,191,144
Cash - End of year	<u>\$ 2,684,212</u>	<u>\$ 3,441,753</u>
Balance Sheet Classification of Cash		
Current assets - Cash	\$ 1,029,159	\$ 2,853,290
Assets limited as to use	1,643,349	588,463
Total cash (Note 2)	<u>\$ 2,672,508</u>	<u>\$ 3,441,753</u>

Three Rivers Area Hospital Authority

Consolidated Statement of Cash Flows (Continued)

A reconciliation of operating income to net cash from operating activities is as follows:

	Year Ended December 31	
	2003	2002
Operating income	\$ 412,421	\$ 1,397,882
Adjustments to reconcile operating income to net cash from operating activities:		
Depreciation	1,839,974	1,864,149
Provision for bad debts	2,544,296	2,429,947
(Increase) decrease in assets:		
Accounts receivable	(3,312,884)	(1,528,621)
Other current assets	(218,954)	(100,072)
Cost report receivable	200,000	300,000
Increase (decrease) in liabilities:		
Accounts payable	(162,517)	(97,367)
Accrued expenses	(239,566)	148,831
Cost report liability	300,000	(50,000)
Net cash provided by operating activities	<u>\$ 1,362,770</u>	<u>\$ 4,364,749</u>

Significant noncash investing and financing activities for 2003 and 2002 were as follows:

In 2003, the Hospital leased equipment under a capital lease. This obligation was for \$185,845.

There were no significant noncash investing and financing activities for 2002.

Three Rivers Area Hospital Authority

Notes to Consolidated Financial Statements December 31, 2003 and 2002

Note 1 - Nature of Business and Significant Accounting Policies

Three Rivers Area Hospital Authority (the "Hospital") is a governmental unit that operates a short-term acute care facility providing inpatient and outpatient health care services to the Three Rivers, Michigan area. TRAH Properties, a wholly-owned subsidiary of the Hospital, leases space to the Hospital for services provided to its patients. Integrated Health Systems (IHS), a wholly-owned subsidiary of the Hospital, employs physicians who work at the Hospital as contracted employees. Physicians Health Organization (PHO) is a joint venture between the Hospital and local physicians to provide computer services, as well as a 50-50 risk share pool to doctors who refer patients to the Hospital.

Use of Estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Presentation – The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by Governmental Accounting Standards Board (GASB) in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued June 1999. The Hospital now follows the "business-type" activities reporting requirements of GASB Statement No. 34 that provides a comprehensive one-line look at the Hospital's financial activities. There was no impact to the net assets of the Hospital in adopting GASB No. 34. No component units are required to be reported in the Hospital's financial statements.

Enterprise Fund Accounting – The Authority uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Authority has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Three Rivers Area Hospital Authority

Notes to Consolidated Financial Statements December 31, 2003 and 2002

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Affiliated Organization – The Hospital has a formal agreement with a local healthcare provider whereby both organizations will work towards the mutual benefit of one another in furtherance of promoting an integrated health care delivery system in Southwest Michigan. The Hospital has available the technical and financial resources of its affiliate (as described in Note 7) and participates in the affiliate's sponsored managed care programs. This affiliation agreement terminates October 31, 2008.

Assets Limited as to Use – Assets limited as to use include assets set aside by the Board of Trustees for future capital improvements and future bond payments, over which the Board retains control and may at its discretion subsequently use for other purposes.

Investments – Investments are carried at market.

Property and Equipment – Property and equipment are stated at cost. Maintenance and repairs are charged to expense as incurred. Depreciation has been charged to operations using the straight-line method and includes amortization of capital leases.

Paid Time Off – The Hospital maintains a paid time off benefit policy. The benefits are charged to operations when earned. Unused benefits are recorded as a current liability in the financial statements.

Net Assets – Net assets of the Hospital are classified in three components. *Net assets invested in capital assets net of related debt* consist of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted net assets* are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees as required by revenue bond indentures. *Unrestricted net assets* are remaining net assets that do not meet the definition of the other two categories of net assets. Included in the unrestricted net assets reported at December 31, 2003 and 2002, respectively, \$2,238,327 and \$1,207,795 has been designated by the Hospital's board of Trustees for future capital acquisitions. Designated funds remain under the control of the Board of Trustees, which may at its discretion later use the funds for other purposes.

Three Rivers Area Hospital Authority

Notes to Consolidated Financial Statements December 31, 2003 and 2002

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Net Patient Revenue – Net patient revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from Medicare and Medicaid programs.

Charity Care – The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care was less than one percent of gross charges for the years ended December 31, 2003 and 2002.

Operating Revenues and Expenses – The Hospital's statement of revenues, expenses and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the Hospital's principal activity. Operating expenses are all expenses incurred to provide health care services, other than financing costs. Nonoperating activities, including investment income and contributions received for purposes other than capital asset acquisition, and interest expense, are reported as nonoperating revenue and expense.

Income Taxes – The Hospital and its subsidiary are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code.

Reclassification – Certain 2002 balances have been reclassified to conform to the 2003 presentation.

Three Rivers Area Hospital Authority

Notes to Consolidated Financial Statements December 31, 2003 and 2002

Note 2 - Deposits and Investments

The Authority's deposits and investments are composed of the following:

2003	Assets Limited		Total
	Cash	as to Use	
Deposits	\$ 1,029,159	\$ 1,643,349	\$ 2,672,508
Investments	-	1,996,434	1,996,434
Total	\$ 1,029,159	\$ 3,639,783	\$ 4,668,942
2002	Assets Limited		Total
	Cash	as to Use	
Deposits	\$ 2,853,290	\$ 588,463	\$ 3,441,753
Investments	-	733,867	733,867
Total	\$ 2,853,290	\$ 1,322,330	\$ 4,175,620

At December 31, 2003 and 2002, the amount of deposits reflected in the accounts of the bank (without recognition of checks written but not yet cleared or of deposits in transit) was \$3,389,044 and \$3,799,149, respectively. The amount of deposits covered by federal depository insurance at December 31, 2003 and 2002 was approximately \$300,000 and the amount of deposits uninsured and uncollateralized was \$3,089,044 and \$3,499,149, respectively.

The Authority believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. The Authority evaluates each financial institution it deposits funds with and assesses the level of risk of each institution. Only those institutions with an acceptable estimated risk level are used as depositories.

Investments – The Authority is authorized by Michigan Public Act 20 of 1943 (as amended) to invest surplus monies (of nonpension funds) in U.S. bonds and notes, certain commercial paper, U.S. government repurchase agreements, bankers' acceptances and mutual funds and investment pools that are composed of authorized investment vehicles.

Three Rivers Area Hospital Authority

Notes to Consolidated Financial Statements December 31, 2003 and 2002

Note 2 - Deposits and Investments (Continued)

The Authority's investments are categorized below to give an indication of the level of risk assumed by the entity. Risk Category 1 includes those investments that meet any one of the following criteria: a) insured, b) registered or c) held by the Authority or its agent.

Risk Categories 2 and 3 include investments that are neither insured nor registered. Category 2 includes investments that are held by the counterparty's trust department (or agent) in the Authority's name. Category 3 includes investments held by: a) the counterparty or b) the counterparty's trust department (or agent) but not in the Authority's name.

	2003			Carrying Amount
	1	2	3	
U.S. government securities	\$ -	\$ -	\$ 937,908	\$ 937,908
Bonds	-	-	90,673	90,673
Total categorized investments	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,028,581</u>	1,028,581
Mutual funds				<u>967,853</u>
Total investments				<u>\$ 1,996,434</u>

	2002			Carrying Amount
	1	2	3	
U.S. government securities	\$ -	\$ -	\$ 433,563	\$ 433,563
Bonds	-	-	-	-
Total categorized investments	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 433,563</u>	433,563
Mutual funds				<u>300,304</u>
Total investments				<u>\$ 733,867</u>

The Hospital routinely invests its surplus operating funds in mutual funds. The funds generally invest in highly-liquid U.S. governmental and agency obligations. Investments in mutual funds are not insured or guaranteed by the U.S. government, but are registered with the SEC; however, management believes that credit risk related to these investments is minimal.

Three Rivers Area Hospital Authority

Notes to Consolidated Financial Statements December 31, 2003 and 2002

Note 3 - Assets Limited as to Use

The composition of these assets is described in Note 2. The classifications and limited uses of these assets are set forth below:

	<u>2003</u>	<u>2002</u>
Current assets:		
Restricted under the terms of the bond agreement for debt service:		
Cash and investments	<u>\$ 158,160</u>	<u>\$ 119,593</u>
Noncurrent assets:		
Restricted under the terms of the bond agreement for capital expansion project:	<u>\$ 1,255,000</u>	<u>\$ -</u>
Designated by Board for future capital acquisitions:		
Cash and investments	2,226,623	1,202,737
Accrued interest receivable	<u>11,704</u>	<u>5,058</u>
Total noncurrent	<u>\$ 3,493,327</u>	<u>\$ 1,207,795</u>

Note 4 - Accounts Receivable

The details of accounts receivable are set forth below:

	<u>2003</u>	<u>2002</u>
Total patient accounts receivable	<u>\$ 10,017,960</u>	<u>\$ 7,885,367</u>
Less allowances for:		
Uncollectible accounts	(1,145,000)	(871,000)
Third party contractual adjustments and interim payment advances	<u>(4,800,000)</u>	<u>(3,700,000)</u>
Patient accounts receivable, net	4,072,960	3,314,367
Other receivables	<u>54,451</u>	<u>44,456</u>
Total accounts receivable	<u>\$ 4,127,411</u>	<u>\$ 3,358,823</u>

Three Rivers Area Hospital Authority

Notes to Consolidated Financial Statements December 31, 2003 and 2002

Note 5 - Capital Assets

Capital asset activity for the year ended December 31, 2003 was as follows:

	Life - Years	2002	Additions	Retirements	2003
Land		\$ 219,500	\$ -	\$ -	219,500
Land improvements	5-25	891,674	11,708	-	903,382
Buildings and improvements	10-40	12,347,175	380,092	-	12,727,267
Furniture, fixtures, and equipment	3-20	15,558,381	487,842	-	16,046,223
Buildings and equipment under capital lease		4,100,074	185,845	-	4,285,919
Total		33,116,804	1,065,487	\$ -	34,182,291
Less accumulated depreciation:					
Land and land improvements		638,052	33,500	\$ -	671,552
Buildings and improvements		4,707,587	695,646	-	5,403,233
Furniture, fixtures, and equipment		12,411,262	849,647	-	13,260,909
Buildings and equipment under capital lease		938,344	261,181	-	1,199,525
Total		18,695,245	1,839,974	\$ -	20,535,219
Net carrying amount		\$ 14,421,559		\$ -	\$ 13,647,072

Capital asset activity for the year ended December 31, 2002 was as follows:

	Life - Years	2001	Additions	Retirements	2002
Land		\$ 219,500	\$ -	\$ -	219,500
Land improvements	5-25	882,959	8,715	-	891,674
Buildings and improvements	10-40	12,270,339	76,836	-	12,347,175
Equipment	3-20	15,004,852	553,529	-	15,558,381
Buildings and equipment under capital lease		4,100,074	-	-	4,100,074
Total		32,477,724	639,080	\$ -	33,116,804
Less accumulated depreciation:					
Land improvements		604,985	33,067	-	638,052
Buildings and improvements		3,987,998	719,589	-	4,707,587
Furniture, fixtures, and equipment		11,542,366	868,896	-	12,411,262
Buildings and equipment under capital lease		695,747	242,597	-	938,344
Total		16,831,096	1,864,149	\$ -	18,695,245
Net carrying amount		\$ 15,646,628		\$ -	\$ 14,421,559

Three Rivers Area Hospital Authority

Notes to Consolidated Financial Statements December 31, 2003 and 2002

Note 6 - Cost Report Settlements

Approximately 72 percent of the Hospital's revenue from patient services is received from the Medicare, Medicaid and Blue Cross of Michigan programs. The Hospital has agreements with these payors to provide reimbursement to the Hospital at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospital's established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with these third-party payors follows:

- **Medicare** - Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient rehabilitation services are reimbursed at cost subject to a per case limit. Outpatient services are paid on an established fee-for-service methodology.
- **Medicaid** - Inpatient acute care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge, plus capital costs on a cost-based reimbursement methodology. Inpatient rehabilitation services are reimbursed at cost. Outpatient services are paid on an established fee-for-service methodology.
- **Blue Cross** - The Hospital is reimbursed its controlled charges for services provided to Blue Cross subscribers.

Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying financial statements.

Three Rivers Area Hospital Authority

Notes to Consolidated Financial Statements December 31, 2003 and 2002

Note 7 - Long-term Debt

A schedule of changes in the Hospital's noncurrent liabilities follows:

	Balance December 31, 2002	Additions	Reductions	Balance December 31, 2003	Amounts Due Within One Year
Bonds payable - Series 1993	\$ 4,240,000	\$ -	\$ 495,000	\$ 3,745,000	\$ 525,000
Bonds payable - Series 1997	2,771,000	-	220,000	2,551,000	240,000
Bonds payable - Series 2003	-	1,500,000	62,066	1,437,934	124,617
Lease payable to an affiliate organization	2,706,596	-	183,341	2,523,255	114,363
Leases payable	244,805	185,845	155,917	274,733	116,282
Total	<u>\$ 9,962,401</u>	<u>\$ 1,685,845</u>	<u>\$ 1,116,324</u>	<u>\$ 10,531,922</u>	<u>\$ 1,120,262</u>

	Balance December 31, 2001	Additions	Reductions	Balance December 31, 2002	Amounts Due Within One Year
Bonds payable - Series 1993	\$ 4,739,167	\$ -	\$ 499,167	\$ 4,240,000	\$ 495,000
Bonds payable - Series 1997	2,981,000	-	210,000	2,771,000	220,000
Lease payable to an affiliate organization	2,883,412	-	176,816	2,706,596	183,340
Leases payable	417,183	-	172,378	244,805	145,006
Total	<u>\$ 11,020,762</u>	<u>\$ -</u>	<u>\$ 1,058,361</u>	<u>\$ 9,962,401</u>	<u>\$ 1,043,346</u>

Bonds payable - 1993 Series, total annual principal payments ranging from \$525,000 due in 2004 to \$715,000 due in 2009, collateralized by net revenue derived from the operation of the Hospital, interest rate 5.59% per annum until November 2003, when the interest rate became variable based on interest rates at that time. At December 31, 2003, the variable rate of interest was 5.44%.

Bonds payable - 1997 Series, total annual principal payments ranging from \$240,000 due in 2004 to \$370,000 due in 2011, with the last payment of \$201,000 scheduled to be made May 2012, collateralized by net revenue derived from the operation of the Hospital, interest rate 5.44% per annum until November 2006, when the interest rate becomes variable based on interest rates at that time.

Bonds payable - 2003 Series, total annual principal payments ranging from \$124,617 due in 2004 to \$177,195 due in 2012 with the last payment of \$91,544 scheduled to be made April 2013, collateralized by net revenue derived from the operation of the Hospital, interest rate is variable and was 4.37% at December 31, 2003.

Three Rivers Area Hospital Authority

Notes to Consolidated Financial Statements December 31, 2003 and 2002

Note 7 - Long-term Debt (Continued)

Lease payable to an affiliate organization, monthly installments aggregating approximately \$23,500 including interest at 5.5% to 6.0% per annum, collateralized by two buildings.

Leases payable, monthly installments aggregating approximately \$21,300, including interest at 5.2% to 7.2% per annum, collateralized by equipment.

Under the terms of the Bond Indenture, the Authority is required to maintain certain deposits with a trustee. Such deposits are included with restricted cash and investments in the balance sheet. The Bond Indenture also places limits on the incurrence of additional borrowings and requires that the Authority satisfy certain measures of financial performance as long as the bonds are outstanding.

Scheduled principal and interest repayments on bonds payable and payments on capital lease obligations are as follows:

	Bonds		Capital Leases	
	Principal	Interest	Principal	Interest
2004	\$ 889,617	\$ 397,394	\$ 230,645	\$ 156,431
2005	925,075	349,497	178,817	145,597
2006	1,031,340	298,895	160,825	135,916
2007	1,087,431	242,955	157,312	126,563
2008	1,128,581	184,273	126,790	118,487
2009-2013	2,671,890	247,627	759,066	467,319
2014-2018	-	-	1,024,576	207,451
2019-2023	-	-	159,957	3,561
Total payments	<u>\$ 7,733,934</u>	<u>\$ 1,720,641</u>	<u>\$ 2,797,988</u>	<u>\$ 1,361,325</u>

Three Rivers Area Hospital Authority

Notes to Consolidated Financial Statements December 31, 2003 and 2002

Note 8 - Defined Contribution Plan

The Hospital maintains a defined contribution retirement plan covering substantially all employees. The Hospital has recognized contribution expense totaling \$442,775 and \$362,989 during the years ended December 31, 2003 and 2002, respectively. Expense was determined in accordance with the plan formula that is as follows:

- 1) An employer discretionary contribution that is based on the proportion of each participant's compensation to the compensation of all participants. A participant is defined as an employee who is classified by the Hospital as full-time or part-time and meets minimum hour requirements per pay period.
- 2) An employer matching contribution of half of an employee's contribution up to a maximum of 2 percent.

Note 9 - Risk Management

The Hospital is exposed to various risks of loss related to property loss, torts, errors and omissions and employee injuries (workers' compensation). The Hospital has purchased commercial insurance for property, fraud, director and officer liability, professional liability, malpractice, general liability, employee medical and workers' compensation claims.

The Hospital is insured against medical malpractice claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claim or aggregate claims exceeding claim limits asserted in the policy year.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during the claims-made term, but reported subsequently, will be uninsured.

There are several pending malpractice claims against the Hospital. There is insurance coverage, but it is possible that the liability for the claims may exceed the aggregate insurance coverage. Presently, it is not possible to determine the resolution of the claims or amount of liability, if any. Accruals for estimated deductibles are included in current liabilities at December 31, 2003 and 2002.



Finance Committee
Three Rivers Area Hospital Authority

We have audited the financial statements of Three Rivers Area Hospital Authority for the year ended December 31, 2003, and have issued our report thereon dated February 26, 2004. During our audit, we had the opportunity to observe the System's procedures for financial reporting and the accounting system. In that process, we made a few observations that we feel should be communicated to you. We have also summarized some additional areas for Management to consider.

Our observations, comments, and recommendations are enclosed in the following exhibits:

<u>Title</u>	<u>Exhibit</u>
Credit Balances in Patient Accounts Receivable	A
PTO Cash Out Policy	B

Thank you for the opportunity to be of service to the Hospital. Should you wish to discuss any of the items included in this report, we would be happy to do so.

Plante & Moran, PLLC

February 26, 2004



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Exhibit A

Credit Balances in Patient Accounts Receivable

During the audit of patient accounts receivable, we noted there were credit balances totaling approximately \$330,000, with almost 65% being older than 365 days. Our review would indicate the largest individual balance was approximately \$7,500 in the oldest aging category. This overall balance is down from last year, which was over \$390,000. We encourage continued focused efforts in resolving the credit balances, particularly in the oldest category.

Exhibit B

PTO Cash Out Policy

During our audit of the accrued paid time off liability, it came to our attention where two individuals were allowed to cash out accrued PTO hours in excess of the stated policy. It is our understanding the policy limits buy-out to 100 hours for hourly employees and 104 hours for salaried employees. Stated policies should be adhered to consistently and all individuals affected by specific policies should be made aware of policy implementation, changes, amendments or revisions.